

**Internal Revenue Service**

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**Legend:**

- Taxpayer =
- Year 1 =
- Year 2 =
- a =
- Entity A =
- Joint Venture 1 =
- LLC 1 =
- LLC 2 =
- b =
- c =
- d =
- e =
- f =

Dear :

This is in reply to a letter dated October 24, 2013, requesting a ruling on behalf of Taxpayer. Taxpayer has requested a ruling regarding the definition of “qualified health care property” under section 856(e)(6)(D) of the Internal Revenue Code, for purposes of the related-party rent exception of section 856(d)(2)(B).

**Facts:**

Taxpayer is a publicly traded corporation that elected to be taxed as a REIT beginning in Year 1.

Taxpayer is in the business of owning and leasing the full spectrum of senior housing and healthcare related real estate, including seniors housing communities, skilled nursing/post-acute facilities, medical office buildings, inpatient and outpatient medical centers and life science facilities. In Year 2, Taxpayer acquired an ownership interest in a senior living facilities through Joint Venture 1.

Joint Venture 1 was formed using two limited liability companies, LLC 1 and LLC 2. Each LLC is taxed as a partnership for federal income tax purposes. The members of LLC 1 are (i) a wholly-owned subsidiary of Taxpayer that is treated as a disregarded entity and a qualified REIT subsidiary (QRS) of Taxpayer for U.S. federal income tax purposes and (ii) an affiliate of Entity A. QRS owns a b percent interest in LLC 1 and the affiliate of Entity A owns a c percent interest in LLC 1. The members of LLC 2 are (i) a wholly-owned taxable REIT subsidiary of Taxpayer (TRS) and (ii) an Entity A affiliate. TRS owns b percent of LLC 2 and the affiliate of Entity A owns c percent of LLC 2.

d of the acquired entities (referred to herein as “Senior Living Facilities” collectively and “Senior Living Facility” individually) have been held in an ownership structure intended to conform with the ownership structure permitted by section 856(d)(8)(B). Each Senior Living Facility is owned by a separate wholly-owned subsidiary of LLC 1 (each referred to herein as “Lessor”). Each Lessor is a party to a master lease agreement with LLC 2 with respect to the Senior Living Facility owned by such Lessor. LLC 1 has further sub-leased each Senior Living Facility to a separate wholly-owned subsidiary of LLC 2 (each referred to herein as “Subtenant”). Each Lessor and each Subtenant are treated as disregarded entities for federal income tax purposes. Each Subtenant, has entered into a management agreement with an affiliate of Entity A to serve as an “eligible independent contractor” (herein referred to as the “EIK”) within the meaning of section 856(d)(8)(B) to manage and operate the particular Senior Living Facility.

The Senior Living Facilities are unlicensed age-restricted residential communities that provide living quarters and significant congregate care services for residents. Taxpayer represents that the Senior Living Facilities offer congregate care and wellness

related services that are not commonly offered by typical multi-family residential rental properties in the markets in which the Senior Living Facilities are located.

The Senior Living Facilities provide full service community meals, housekeeping services, scheduled transportation services, 24-hour staff, daily social programs, events and outings, general maintenance service for units, paid utilities, and on-site beauty salon and store. The Senior Living Facilities also offer a fitness center and daily fitness classes, 24-hour emergency response system, personal emergency pendants, maintenance of current "Do Not Resuscitate" (DNR) forms for residents upon request, sharps containers are made available for use in residential units for medical bio-hazard disposal, oxygen use is permitted in residential units with compliance with local laws monitored by the on-site manager, on-site rehabilitation clinic for physical, speech and occupational therapy. Also offered to all residents are: (i) screenings conducted by licensed therapists and nurses employed by an Entity A affiliate at each Senior Living Facility, (ii) meetings with clinical directors to discuss pro-active intervention for residents who may be at risk of falls, a decline in physical health, and/or cognitive impairment, and (iii) an on-site director with responsibility to promote resident health, independence and self-management through educational programs, community and supportive services, hospital tracking, and communication with family members.

In addition to the foregoing standard services, for an additional fee, some or all of the Senior Living Facilities offer outpatient therapy services, hospice services, home healthcare services and companion services. The outpatient therapy is provided in an on-site clinic by appointment, with costs covered by Medicare and/or secondary insurance.

Hospice services are currently available or pending at one Senior Living Facility and are provided by a licensed hospice agency. These services are pending at the other Senior Living Facilities. The hospice services include all levels of palliative care, as well as bereavement services for the family. The hospice care is covered by Medicare.

The home healthcare services are provided by licensed home health care agencies and are generally covered by Medicare, for a 60-day period, with re-evaluation and re-certification if needed.

The companion services are provided by Certified Nursing Assistants. The services are covered by long-term care insurance or private pay.

The residents at each of the Senior Living Facilities are also eligible to participate in a resident transfer program. The resident transfer program benefits include: (i) free basic services at a higher level of care for e days annually and up to f days cumulative, (ii) priority access to a higher level of care at other facilities, (iii) ability to transfer

residency to a facility offering a higher level of care without paying another community entry fee and (iv) reduced annual basic service fee increases for long-term residents.

Taxpayer is requesting a ruling that its ownership interests in the Senior Living Facilities represent interests in real properties that are “qualified health care property” within the meaning of section 856(e)(6)(D). Specifically, Taxpayer requests a ruling that the Senior Living Facilities are “congregate care facilities” within the meaning of section 856(e)(6)(D)(ii) and, as long as the Senior Living Facilities are operated by an eligible independent contractor (EIK), any amounts derived by Taxpayer from its ownership interest in LLC 1 shall not be excluded from the definition of “rents from real property” by operation of section 856(d)(2)(B).

### **Law and Analysis:**

Section 856(c)(2) provides that at least 95 percent of a REIT’s gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT’s gross income must be derived from, among other sources, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(B) provides that rents from real property do not include amounts received directly or indirectly from a corporation if the REIT owns 10 percent or more of the total combined voting power or 10 percent or more of the total value of the shares of the corporation.

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) when a REIT leases a qualified lodging facility or qualified health care property to a TRS, and the facility or property is operated on behalf of the TRS by a person who is an eligible independent contractor.

Section 856(d)(9)(A) provides that the term “eligible independent contractor” with respect to any qualified health care property (as defined in section 856(e)(6)(D)(i)) means any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the TRS to operate such

qualified health care property, such contractor (or any related person) is actively engaged in the trade or business of operating qualified health care properties, respectively, for any person who is not a related person with respect to the real estate investment trust or the taxable REIT subsidiary.

Section 856(e)(6)(D)(i) defines qualified health care property as any real property which is a health care facility.

A "health care facility" is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which was operated by a provider of such services that is eligible for participation in the Medicare program under Title XVII of the Social Security Act [subchapter XVIII of chapter 7 of Title 42 (42 U.S.C.A. § 1395 et seq.)] with respect to the facility.

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partnership for all purposes of section 856.

In the present case, the Senior Living Facilities offer services that have a significant health care related focus, with the goal of offering a medical services intensive environment for senior citizens who are generally physically able to care for themselves. The programs offered at the Senior Living Facilities are targeted to monitor and help improve the health and well-being of the senior citizen residents. For example, the EIK at each Senior Living Facility maintains a permanent full-time employee who is in charge of matters such as (i) establishing health related educational programs, (ii) coordinating services with third party medical providers, (iii) monitoring the suitability of the living environment for the residents and proposing alternatives where necessary, and (iv) communicating with family members regarding the medical needs of the residents. The EIK also supports and monitors certain health-related activities of the residents, for example by making available certified nursing assistants and licensed therapist, by monitoring the use of in-unit medical equipment such as oxygen, by providing for emergency call pendants and first responders, and by maintaining DNR Forms. At the option of a resident, numerous other personalized health services are also available. Further, through the resident transfer program offered by the Senior Living Facilities, senior citizen residents who are in need of a more intensive level of medical related services and care are able to easily transfer to another community.

These healthcare related services and alternatives for residents are not available in a typical multi-family residential rental property.

**Conclusion:**

Based on the facts as represented, we rule that the Facilities are congregate care facilities within the meaning of section 856(e)(6)(D), and therefore, constitute “qualified health care properties” within the meaning of section 856(e)(6)(D). Accordingly, amounts paid to the Taxpayer by the TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) if the Senior Living Facilities are operated and managed by an eligible independent contractor.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code or whether Contractor qualifies as an eligible independent contractor under section 856.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Jonathan D. Silver  
Jonathan D. Silver  
Assistant to the Branch Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)